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Mar. 10, DJIA 758.58; PTI 707; A-D Ratio −21.48
Mar. 17, DJIA 770.79; PTI 726; A-D Ratio −20.75

THE MARKET: Einstein once remarked that ***"there are only two things that are infinite–outer space and human stupidity."*** By the same token, in the stock market there is only one commodity that is in perpetual short supply–PATIENCE. For instance, a bear market "knows" that if it mills and lolls about, works sideways, sinks subtly lower, investors and traders will grow impatient. Some of these souls will then leave the Street (as they are now doing), while others will say, "What the devil," and they will take a speculative flyer on a few stocks. Thus, the bear market by trying mens' patience, drives some out of Wall Street while it simply parts others from their assets.

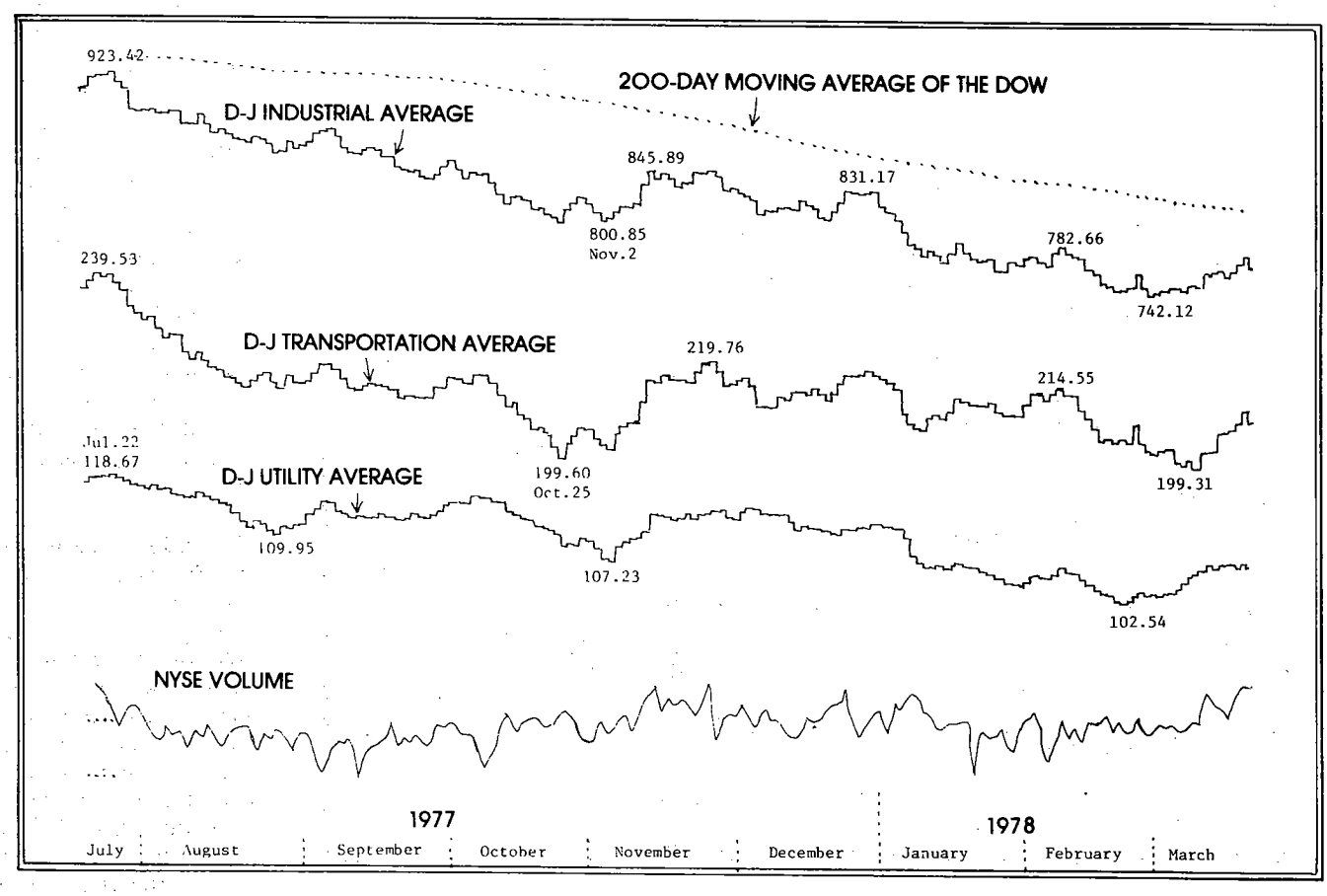
I think I read about as much on the market as anyone in this business. I read dozens of investment services each week, tens (it seems like hundreds) of magazines, I read six newspapers a day, and I sandwich in a book or two every few weeks. It's a lot of reading, but it does give me a feel for the prevailing sentiment. And I will say this: people are getting disgusted with the stock market, the economy, inflation, Carter, the Government, Panama, energy, taxes, the dollar, the weather, you name it.

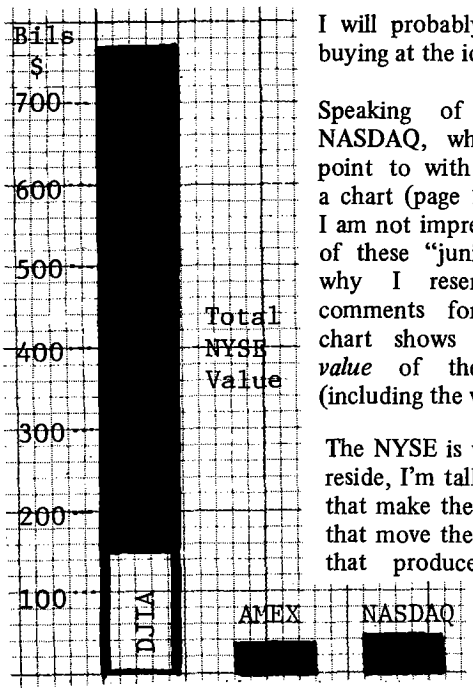
Dan Dorfman in the March 28 issue of the excellent new *Esquire* interviews Robert Wilson (Dorfman calls Wilson the "Wizard of Wall Street" because he's done so well). Well, the wizard is taking a 6-month vacation. Writes Dorfman, *"Wilson's vacation could have dismal–and significant–overtones for investors. The message: maybe they ought to take a vacation too."*

Maybe, but I also note that many of the fairly intelligent advisory letters are now talking about a bottom in the market which is either (1) in the process of formation now or (2) slated for somewhere directly ahead. And I'm not arguing with those opinions. But I am saying this: So far, my data and indices are not showing me an over-sold market condition or a real bottom.

And no matter what I think or project or predict, I go by the actual data and facts. I've been thinking all along that we should get some kind of a decent low during the first quarter or certainly the first half of 1978. But as of now, it just isn't here!

I also think that when the bottom does come, it won't be the beginning of a towering new bull market. Rather it will mark the beginning for either a good advance or a major upward correction in a bear market. For that reason, I will probably be reasonably careful about the long side of the market if such a bottom materializes. Only one thing could change my strategy over the foreseeable future. And that would be a drastic "wipe-out" in the market, a really major decline which would result in a crash in the breadth on the NYSE plus a comparable crash on the AMEX and the NASDAQ. If such a collapse comes to pass,





I will probably recommend heavy buying at the identifiable bottom.

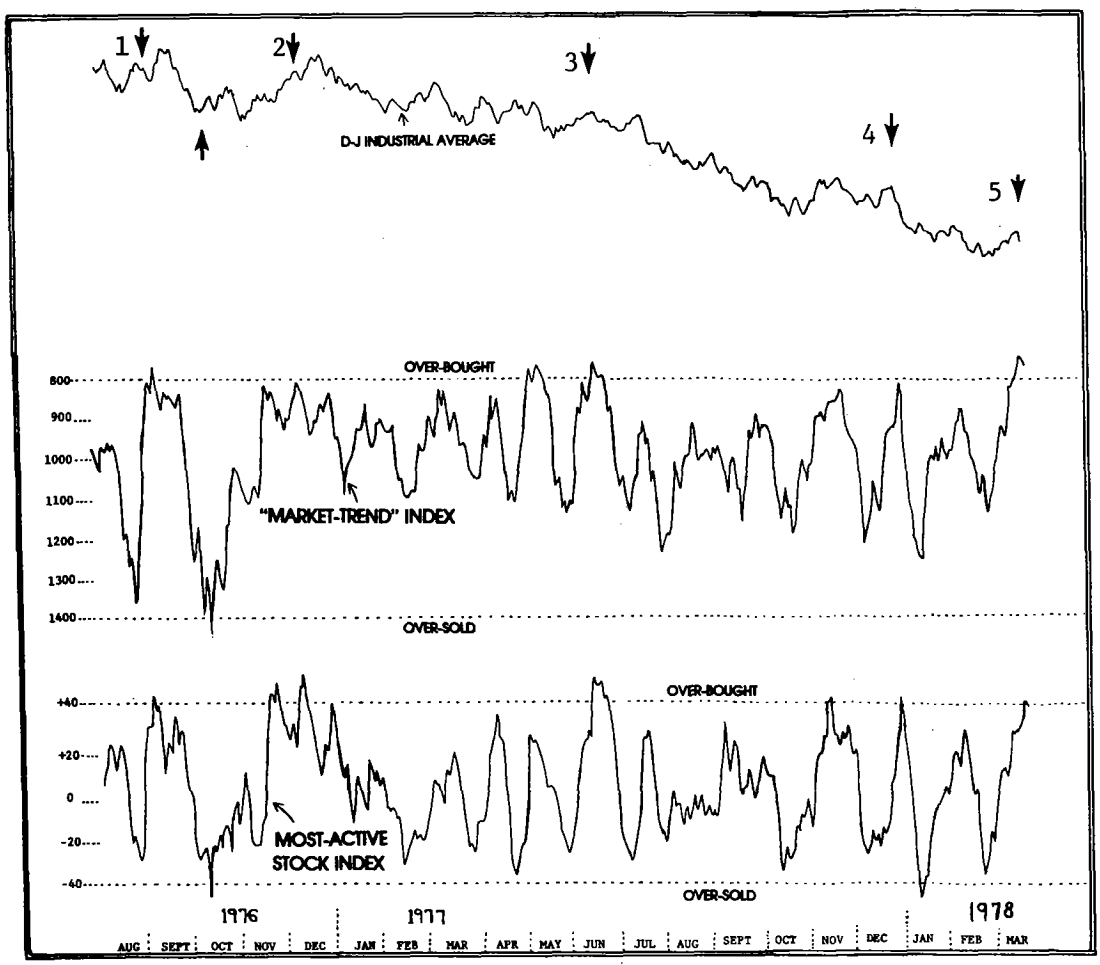
Speaking of the AMEX and NASDAQ, which so many now point to with awe, I have drawn a chart (page 2) which shows why I am not impressed with the action of these "junior" exchanges (and why I reserve most of my comments for the NYSE). The chart shows the *relative dollar value* of the three exchanges (including the value of the Dow).

The NYSE is where the "big guns" reside, I'm talking about the stocks that make the economy, the stocks that move the economy, the stocks that produce the figures that count. In fact, two stocks, IBM and AT&T on the NYSE are comparable in value to the entire listed capitalization of both of the smaller exchange listings.

At any rate, what I want to get across to subscribers here in this section is that there's no way we can make the market work for us. It's we who have to do the work–and the work is learning about the market. Our number one lesson in "market-ology" is patience. There's seldom a year when Wall Street doesn't give us at least one "entrance-point" for at least one profitable advance. The year 1977 came and went without producing a bargain buying area, and the odds are that 1978 will be kinder to us. But patience . . . .

Turning to the page 1 chart it's clear that since the Dow Industrial low of February 28 or even since the Utility low of February 22, the upside progress has not been exactly spectacular. In three weeks of upside huffing and puffing accompanied by rather high volume, the Industrial Average has gained approximately 3.5% . Transports have added about 4%, and Utilities too have tacked on around 4%. That's not too much yardage, considering the amount of steam (volume) under the market boiler. In fact, the lack of upside progress in the Averages smacks a bit of "churning" to this observer. Nevertheless, the message of the market seems to be coming through as "C'mon in y'all, the water's fine.!"

Turning to my chart of the over-bought and over-sold indicators, we get a most interesting picture. For the fifth time since September, 1976, my two indicators have registered an over-bought condition for this market. An over-bought signal is given when the 10-day average of the "market trend indicator" moves into the 800 (or less) area confirmed by a rise in the 8-day moving average of the NYSE most actives to the 40 level (or above). On March 17 the market trend hit 808, and on the same day the most-active index recorded plus 42. While the market may go higher, any further advance will simply give us greater strain on the upside.



The record of the four most recent over-bought signals is as follows. On September 10, 1976 (1 on chart) the indicators reached an overbought, and the Dow dropped from 988 to 925. On December 14, 1976 (2 on chart) two indicators registered overbought and the Dow dropped from 976 to 916. On June 20, 1977 (3 on chart) an over-bought dropped the Dow from 924 to 802. And on December 30, 1977 (4 on chart) an overbought was recorded at Dow 830. The Dow subsequently sank to 742.

Conclusion: Each over-bought came at a lower level on the Dow. The Average drop in the Dow following these four over-boughts was 83 points. If the current over-bought were to produce the same kind of action, we might expect a drop by the Dow into the high 600's (or lower). But the thing that is so extraordinary about

this market is that none of the over-bought areas since December, 1976 have been followed by an over-sold condition. In my opinion, each time a decline fails to produce an over-sold, it **increases the odds** that the next decline will indeed produce a major over-sold situation.

By the way, almost every advisory publication that I read now seems to carry the following message: "Isn't it bullish that all the advisory publications are so bearish!" Well, maybe so, but I think this contrary opinion regarding the advisories is being done to death. The advisories may be "all bearish," but it's strange that THE MARKET won't become bearish enough to drive my two indicators down to a real over-sold area! Furthermore, speculation on the AMEX and NASDAQ continues day after day. If all this adds up to a great spate of bearishness, then as far as I'm concerned we'll have to change the definition of what a pessimistic market looks like.

ADJUSTING FOR INFLATION: I don't think a week goes by without someone wanting to know why I don't talk about the Dow "adjusted for inflation." Well I do discuss this problem periodically, but I want to go into it again now.

The accompanying chart is from *Horsey*, Salisbury, MD 21801. What we see here is a monthly chart of the Dow, but a Dow adjusted by the Consumers Price Index (on the CI the 1967 prices equal 100). In other words, we're looking at a Dow adjusted for the deterioration in purchasing power brought on by inflation. The CI is also charted so that the path of consumer prices can be seen clearly.

There are two viewpoints which may be taken. The first is a strict Dow Theory interpretation, which states that the Averages adjust for everything. That "everything" includes earnings, social change, Government edicts, taxes, cyclical effects, the weather, you name it–plus, of course, inflation. In other words, from the standpoint of orthodox Dow Theory, inflation is just another item which is factored into the price of the Dow. Thus the Dow needs no adjusting.

From the statistician's standpoint, it may make sense to at least follow the Dow on an inflation-adjusted basis. The argument is as follows: Take a stock such as Eastman Kodak. In 1965 EK was selling in the 40 area, about where it is today. Yet during those 13 years the Consumers Index has risen from 96 to approximately 186, or almost 94%. So in terms of purchasing power, the investor who has held EK since 1965 has lost almost half his money. Thus, says the statistician, it is a lie to say that the man who has held EK since 1965 is breaking even. In terms of purchasing power, he has suffered a disastrous loss.

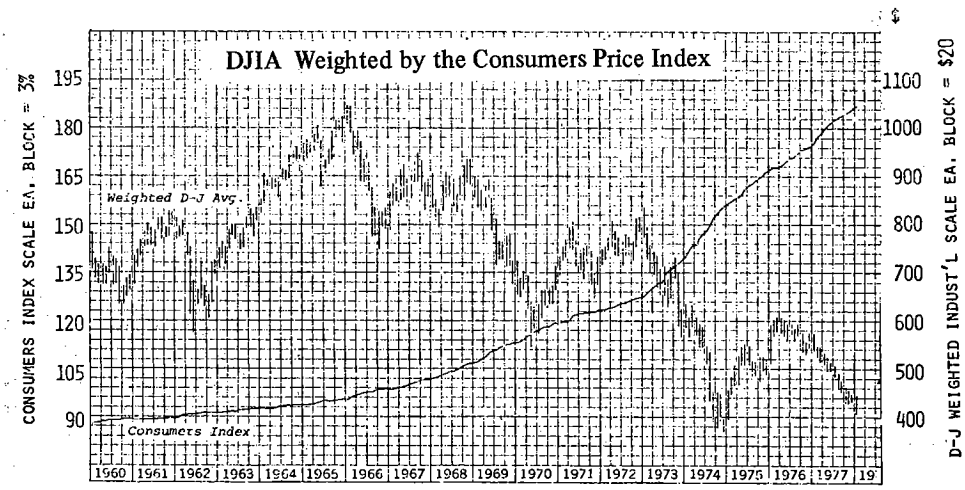
My own viewpoint is that both sides have interesting arguments, but the inflation adjustment argument bothers me. Since there is always some degree of inflation or deflation, this would mean that we would be constantly adjusting the Dow. Furthermore, we don't really know why the Dow (today) is back at its 1961 high (which it is). Part of that dismal performance may be due to the lower quality of earnings, part may be due to the Government's attack on the large corporations, part may be due to changing accounting procedures, changing social views, or the rise in corporate debt or a hundred other items.

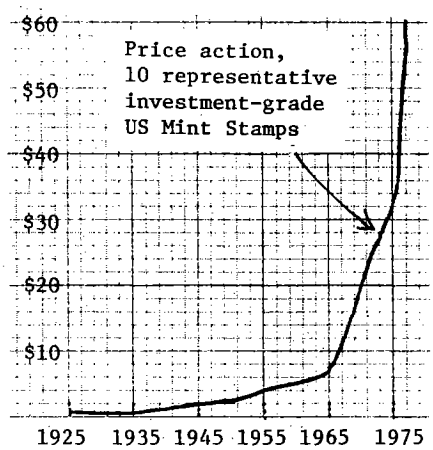
What we do know is that the stock market in general has gone nowhere in well over a decade, and the inroads of inflation have made that "nowhere performance" look even worse to the average stockholder.

Along these lines, I thought this excellent comment from *Parker, Lawhorn, Morgan* (567 San Nicolas Dr., Newport Beach, CA 92660) explains a lot. "*The rules are changed. With gold in discard and nothing backing our money other than the promises of politicians, the road to hyper-inflation is the path of least resistance. To accurately assess the present condition of the market, any statistic depending on the US dollar for a part of its measurement must be adjusted for inflation. With a 7-8% inflation rate, the old 10 times earnings yardstick must be lowered to 5.5 times to achieve the same result. The 3.5% dividend of 1967 would have to be increased to 11% to pay off in 20 years–and even then we must make the unlikely assumption that the politicians will hold inflation below 8% for the next 20 years.*"

Of particular interest to me is the fact that the inflation-adjusted Dow, as seen on this chart, topped out in **February, 1966**, at the exact point where I first called "the end of the great Post-War bull market. This 1966 peak jibes with the Elliott viewpoint as discussed in Letter 723.

The broad 12-year collapse in the purchasing power of the stock market brings me to a subject which I have written a good deal about over the past year. This is the subject of "collectibles" as **stores of value**. During December, 1976, when I was in NYC to appear on the Barron's Panel, I spoke to Editor Bob Bleiberg about the waning purchasing power of stocks. At that time we talked about collectibles and non-stock values. I said that I thought "the coming thing" was the whole area of the collectible, including stamps, coins, antiques, porcelains, art, etc. We must have been of the same mind, since I note that





Barron's now has specific issues which feature various categories of collectibles. Obviously Bob Bleiberg saw the same writing on the wall that I did. And I believe the writing said this: "The corporate area is facing increasing difficulties from almost every quarter. There is a liquidity squeeze, a squeeze on earnings, a persistent high level of interest rates, increasing regulations, paper work and red tape, higher wages, pension plan difficulties, Social Security payment boosts, plus dozens of other problems for corporations, not the least of which is vicious foreign competition.

All of this means that investors have had to search for **alternate stores of value.** Furthermore, the whole concept of a piece of paper (the stock certificate) which says that you "own" a percentage of some corporation–is coming under increasing skepticism. The stockholder sees his piece of paper shrinking in value, he sees it "taken over by another company," he sees it lower a dividend, he begins to feel that "his piece of paper" has little to do with the company that is "out there somewhere."

But the collectible or a home or a piece of land is different. You can see it, you can touch it, and if it's a coin or a stamp or a work of art you can put it in your home or in your vault. It's yours, it can't go bankrupt, it can't be taken over, it won't "disappear" in value.

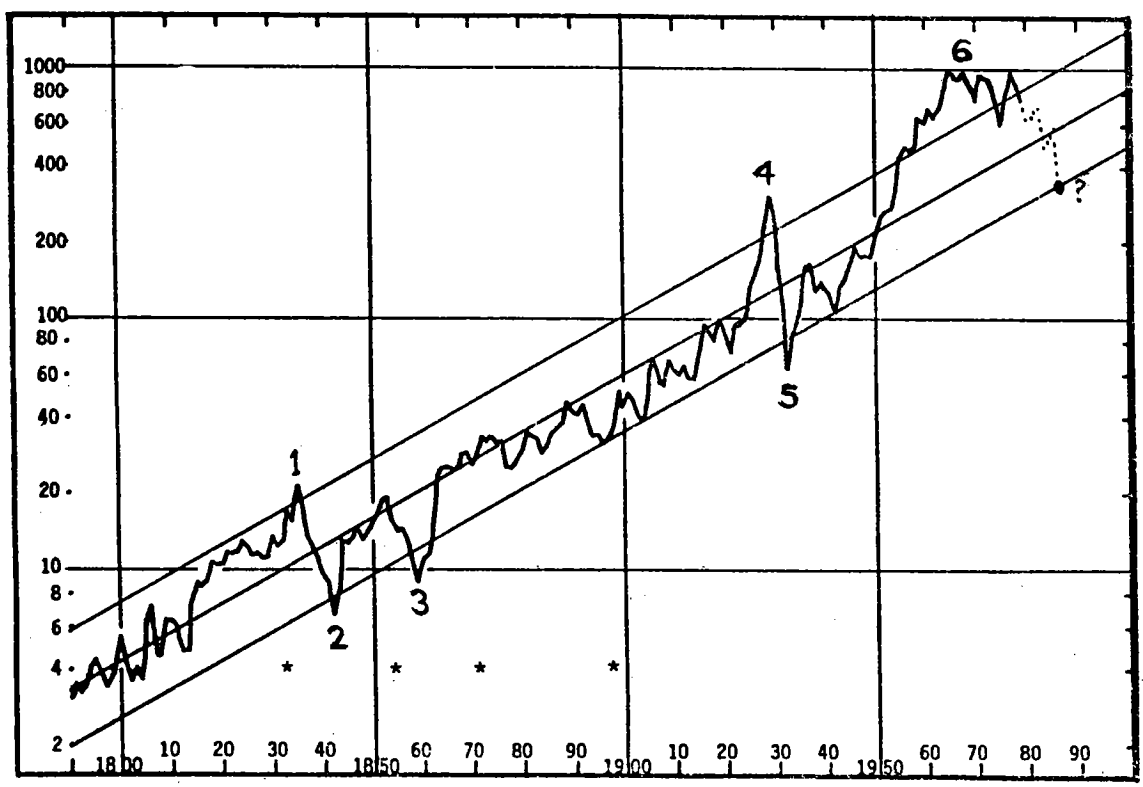
Last week I talked to Myron Kaller, a well known stamp agent and philatelic expert (PO Box 665, Hicksville, NY 11803). I said "Myron, how do you account for the tremendous and gathering interest in stamps and what do you see ahead?" He answered, "I believe that a very large amount of stock market and security money is now going into the stamp market for investment purposes. Furthermore, I detect increasing Wall Street interest in this area."

This concurred with my own observations about the stamp field. The breadth and range of interest in stamps is extraordinary, and there is even talk of a national stamp exchange which would be modeled somewhat in the same fashion as the stock exchange. Furthermore, it occurs to me that when a nation runs into severe difficulties (as the US is doing now), it tends to look away or look back. The current explosion in occult and science-fiction movies represents, in my opinion, an escape from reality, a "looking away from today's horrendous problems." The "Roots" syndrome also represents a looking back to the seemingly happier days of the past. I believe that the current intense interest in collectibles, antiques, Americana, may have a lot to do with a turning back to history, a desire to collect and possess items of the past which possess undeniable and increasing value.

There are two ways of looking at the increase in value of some of the better stamps. For instance. the $5 Columbian issue could have been purchased at a US Post Office for face value in 1892. The stamp in superb condition now sells for as much as $4000. The widely-used 1863 Andrew Jackson 2 cent stamp (the "Black Jack") cost 2 cents during the 1860's. A good mint copy will sell for over $50 today. Thus the appreciation has been simply phenomenal.

But just as interesting is that the real acceleration in many stamp prices started around the mid-1960's (see chart, page 3) at just about the time the Dow and many stocks topped out. So I find it rather hard to believe that the top-out in stocks and the beginning of the big price move in collectibles had nothing to do with each other. No, the march out of stocks has occurred simultaneously with the march into collectibles.

At some point in the period ahead, a huge deflation may knock the price of stocks further down and collectibles down with stocks. Or collectibles may tend to hold relatively better than stocks. But my own guess is that the public and the markets will ultimately push both trends too far. At some point, therefore, collectibles will tend to be a sale and stocks will tend to be a buy. I sincerely doubt, however, that we are there yet.



SWIMMING THE CHANNEL: I have received a great deal of comment regarding the Elliott study in Letter 723. Subscribers have not been arguing the implications of that study; they simply want to know more.

At this point I want to approach the whole subject from another standpoint and an entirely different kind of chart. This is a semi-logarithmic (ratio scale) chart that was published by the Foundation for the Study of Cycles about 14 years ago. I have kept it up to date. The price action is made up of a number of different indices, but it probably constitutes

the best record we have of continuous stock prices since the 1700's. The asterisk marks (*) on the chart show where a stock index has been merged into another for the sake of continuity (the latest change occurred in 1896, when the Dow was used. The Dow continues to the present).

Note that from 1800 to 1955, with a few rare exceptions, the price movement held **within** the confines of the two channel lines. Furthermore, the price movement appears to rally and decline pretty much within striking distance of the center line (the line midway between the two channel lines).

I have marked the 6 instances in which the price structure either thrust above the upper channel line limits or collapsed below the lower channel limits. Point 1 (I base this on my own historical studies) was probably caused by the intense activity connected with the Morris Canal speculations. Here the market saw its first "short corner," a corner which was engineered by Jacob Little (he is credited with inventing the short sale). During this period, the Morris Canal stock rose from almost nothing to a price of $185 per share.

At point 2 prices totally caved in as the market discounted the vicious depression of the early 1840's, a depression that ended in 1843. At point 3 the price structure again collapsed, due to the great Banking Panic or "Western Blizzard," as it was called. Business was prostrate for 7 months and banks suspended payment. It was then that financier Jay Cook made his famous announcement, "Money is not tight, it is not to be had at all."

Point 4 needs no explanation. It is the peak brought on by the wild and wooly speculation of 1929. At point 5 the piper was paid, as the Dow sunk to the famous July, 1932 low of 41.22, and the Great Depression was on.

Now we come to the modern instance at point 6. Around 1955-56, the Dow pushed over the top of the channel. Two years later, under the impetus of an increasingly inflationary environment, the yield on the major stock indices dropped below average bond yields. This "Negative spread" has remained ever since. In February, 1966, the Dow advanced to a peak of 995.15, at which time I felt the main thrust of the great bull market was over.

Ten years later the Dow was still attempting to push above 1000, but the effort was in vain. Despite the greatest debt build-up in world history, despite years of deficit spending and expanding money supply, the 1976 thrust (like all the others before it) failed to take the Dow appreciably above 1000.

What happens next? My belief is that the quarter of a century which has seen the Dow above the upper channel line, will be followed by a major bear market, a bear market which started subtly in 1966 (see last Letter) but which now is becoming more pronounced. Ultimately, I think it is possible that we will see the Dow not only touch the center line of the channel (that line is now at Dow 570) but extend its decline until the bottom of the channel is touched. If this is to be the extended bear market that I think it will be (with intermittent mini-bull markets, of course), we could see the Dow somewhat below 300 by the mid-1980's.

"How could this happen?" you ask, "How could such a thing possibly happen?" And my answer is that the greater the speculative edifice, the greater the fall. The inflation-speculation edifice that has been built up since 1956 dwarfs anything seen in US history. Thus, the bear market should be just as spectacular. Diminishing dividends, Government encroachment, institutional and public pessimism, bankruptcies, all of these should feed the bear market as it makes its way to lower levels.

In view of all this, I offer only one intuitive prediction of my own (of course the whole scenario is really a prediction, but this is a more personal one). I believe that sanity will ultimately rule in this country. I think the swing will be back to a form of fiscal conservatism which will ultimately save the nation. I believe that in time the deficit spending road that this country has been following will be seen for the deceitful trap that it is. By the mid-1980's or perhaps a bit before, a new and healthy bull market of super-cycle duration and extent will be born. To get from here to there will be a major problem, a problem which will undoubtedly require all our knowledge, skill and intelligence. And patience.

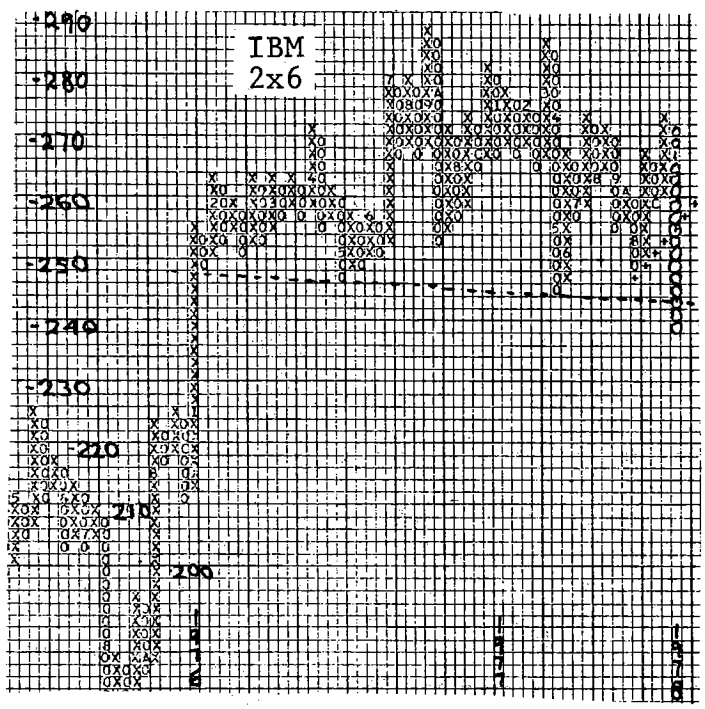
ODDS & ENDS: Despite the supposed "pessimism" which darkens the 1978 markets. customer debt on the NYSE reached a record high of $9.78 billion at the end of February. This topped the December, 1977 figure of $9.74 billion. The borrowing in this market is amazing, particularly when you realize that many rates are above 9%.

* *

With the drop in homebuilding and auto sales, the outlook for the economy has turned dim. A few economists even predict zero GNP growth for the first quarter. On top of this, cattle and hog prices are now surging, and this practically guarantees a whopping jump in food prices and the Consumers Price Index as the year wears on.

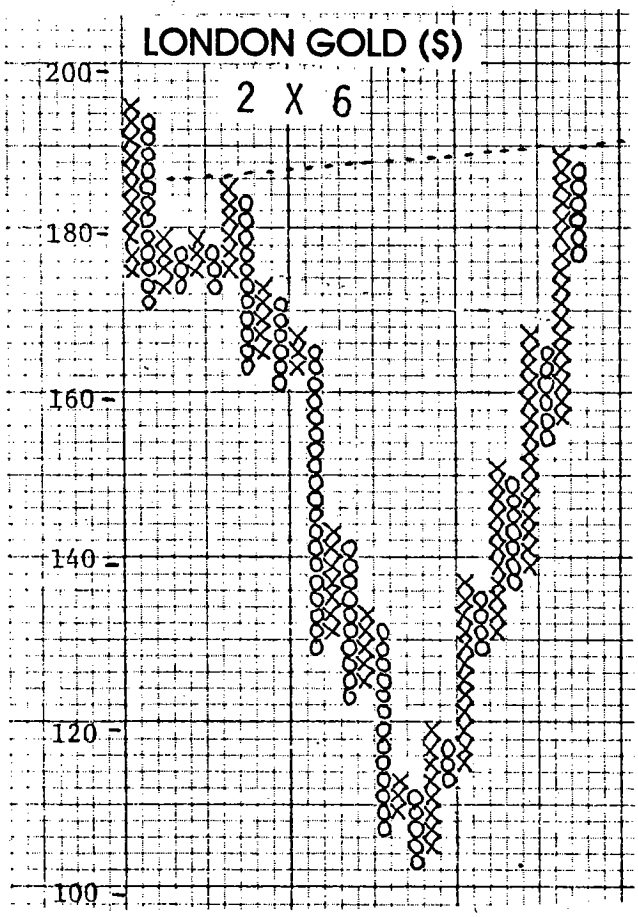
* *

To me, one of the most interesting situations in the markets is the "battle of IBM." The accompanying P&F chart (courtesy of Chartcraft, Larchmont, NY) shows that immense two year head-and-shoulders top in IBM. The downside break came a few weeks ago when the stock broke support at the 244 level, and since then it's been a daily battle with IBM unable to put together anything in the way of a rally. My guess is that in due time, we'll see substantially lower prices in this giant computer stock.



GOLD: There are two kinds of gold buyers. The first kind (and this is what I've advocated) puts 10% to 20% of his assets in gold coins or gold bullion as insurance against the day when hyper-inflation (or some other brand of monetary chaos) sweeps over the land. This conservative gold-buyer doesn't wax poetic when gold rallies 20 points and he doesn't pop Valiums when gold drops 20 points. Gold is this man's core possession of real money; it's simply part of his program of diversification. This conservative gold-buyer knows that he is in a grim struggle for his financial life during an era when his Government has embarked on the biggest program of forced inflation and debt building in world history. To him, "survival" is the name of the game, and gold is the ultimate "life preserver," the bottom line in his survival package.

The other kind of gold buyer is the speculator, the man who is out to "make a killing" or at the least to "beat the gold market." He may be highly successful with his trading or he may miss a few moves here or there. But my bet is that before he's through he's going to be taken out or "stopped out." This fellow might as well be trading bellies or wheat or corn as gold. I have not advocated speculating in gold, and I am not going to start now. My own feeling is that the gold speculator is going to end up making little or nothing on his money—and he is not going to have the insurance policy which I feel a conservative position in gold represents.



At 190 (as I stated in the last Letter) gold had gone too far too fast. Was everyone who had climbed aboard during that heady run-up from 158 to 190 fated to make a golden fortune? Hardly, and the gold market suddenly fell away, probably knocking off every "stop loss" (in the futures market) on the books. Note on the page 6 chart that the gold price has corrected sharply down to the approximate level of the 13 week moving average (the 13-week now stands at 176). This is the fourth time since August, 1977 that the gold price has come down to test the 13-week MA. The only time in the last year that gold broke below the 13-week MA was during May-July, 1977.

Thus, there is a fairly good chance that gold will hold in the vicinity of the 13-week MA, as seen on the chart, consolidate, and then move higher—probably in due time to test its 190 high of 1978.

On the concentrated version of the point & figure chart, the 2X6 chart as seen on page 6, gold is now in the process of forming a "right shoulder." This is what I suggested might happen (see last Letter). To my mind, the best possible action for gold during the period ahead would be a backing and filling between the 190 high and the 170's, and then an ultimate "break-out" above 190. Such action, if it occurs, would be a powerful prediction of new all-time highs to come for gold.

LATE NOTES: Responding to the big over-bought condition as seen on the page 2 chart, the Dow dropped 10.91 points on March 21. It is notable that the rally at the March 20 high of 773.82 failed (at least so far) to add even 5% to the Dow. Furthermore, the 10.91 drop of March 21 was greater than any daily Dow rise on the advance. Thus, the Dow goes down much easier than it goes up. This is the fourth downturn from an over-bought situation since late-1976, and it remains to be seen whether this decline will lead to "the big one," and by the big one I mean the slide that will take the entire market to a full over-sold situation. Sooner or later we're going to get just that, and the hidden ingredient (as I've been saying all along) is patience.

I'm asked "how much" it will take on the Dow to send the market down to an over-sold area, and I can honestly say I don't know. I never would have believed that the Dow could drop all during 1977 and into 1978 without producing fear, shock and loathing on Wall Street—but so far, all we've been seeing is lower stock prices, plus complacency. My guess is that it's going to take a real downside smash to produce a full over-sold. Until then, we wait.

I could never understand the psychology of the man who will sweat bullets in his own business, then take an uninformed and asinine "flyer" in the stock market. As for me, I still appreciate the bucks I make, I can still buy a good steak for six greenbacks, and I prefer going into the market ONLY when I feel the odds are most heavily with me.

NEXT MAILING: April 5th